Fiscal Note 2009 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Bill #	SB0197	**Title:**	Divestiture of investments in terrorist nations
Primary Sponsor:	Weinberg, Dan	**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
Other - Proprietary Fund	$161,500	$117,500	$117,500	$117,500
Revenue:				
Other - Proprietary Fund	$0	$0	$0	$0
Other - Pension Fund	- - - - - - - - - - - - - -(unknown, likely significant and adverse) - - - - - - - - - - - -			
Net Impact-General Fund Balance	$0	$0	$0	$0

Description of fiscal Impact: There would be two types of fiscal impacts, nearly all of which would impact the state's pension funds. The hard dollar costs shown above can be roughly estimated. The impact on pension fund investment return cannot be determined with any accuracy but could be significant. The return going forward would be impacted by transaction costs, market impact costs, lost income opportunity, and reduced diversification.

FISCAL ANALYSIS

Assumptions:

Department of Commerce (DOC)

1. The bill requires the Board of Investments to divest and not purchase any investments in "companies engaged in providing assistance to terrorist activities or to companies who do business in nations determined by the U.S. Government to be terrorist states." The determination of what constitutes terrorism and a terrorist state must be in alignment with the office of terrorism finance and economics policy within the U.S. Department of State.
2. The State Department website lists five countries as sponsors of terrorism: Cuba, Iran, North Korea, Sudan, and Syria. The State Department does not provide a list of U.S. or foreign companies that conduct

business with or within these countries. No agency within the U.S government, including the Securities and Exchange Commission, offer guidance or assistance to investors in identifying these companies and recommending appropriate action.

3. Board staff have identified only one private vendor that claims to provide a list of companies doing business with or within these countries. The list is not reviewed by the federal government for accuracy or reasonableness and the board has no capability to review these lists for accuracy.
4. The vendor states that it identifies more than 400 companies with ties to these countries but charges $12,500 for the list. Board staff were able to gain free access to the site to sample 10 companies on the list. Several of the sampled companies were household names, including Chevron, ConocoPhillips, Coca-Cola, and Halliburton. As of December 31, 2006, the board held more than $100.0 million in stocks and bonds of the 10 sampled companies, nearly all in pension fund portfolios.
5. To implement this legislation, the board would have to purchase the vendor's list for internally managed portfolios at an annual cost $12,500 and would also purchase the list for 11 external separate account managers at an approximate annual cost of $3,000 per manager. The manager contracts would be amended to prohibit investments in the listed companies and the custodial bank would create 11 "custom" performance benchmarks for these managers at a one-time cost of $4,000 each.
6. The board would hire an additional FTE to supervise and monitor the activity required by this legislation at a securities analysts pay rate. The estimated cost for salary and benefits of the FTE would be $72,000 per year.
7. The board would have to divest $2.9 billion in "commingled" accounts for the pension funds and state workers compensation fund. The board has no control over the securities held in these accounts and could not risk that the accounts could hold or purchase the prohibited securities. The $2.9 billion would have to be invested in separate accounts over which the board could exert control. The transaction costs, market risk, lost income opportunities, and reduced diversification resulting from the divestiture of commingled funds cannot be estimated.

	FY 2008 Difference	**FY 2009 Difference**	**FY 2010 Difference**	**FY 2011 Difference**
Fiscal Impact:				
FTE	1.00	1.00	1.00	1.00
Expenditures:				
Personal Services	$72,000	$72,000	$72,000	$72,000
Operating Expenses	$89,500	$45,500	$45,500	$45,500
TOTAL Expenditures	$161,500	$117,500	$117,500	$117,500
Funding of Expenditures:				
Other - Proprietary	$161,500	$117,500	$117,500	$117,500
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
Other - Proprietary	($161,500)	($117,500)	($117,500)	($117,500)

Long-Range Impacts:

1. Restricting the investment of pension funds could have serious long-term impacts on investment return, which in turn could negatively impact the existing unfunded liabilities.

<u>Technical Notes:</u>

1. The restrictions on investments contained in this bill may conflict with the constitutional requirement [Section 13 (3) (4)] that investment of the pension funds and state workers compensation fund be managed in a fiduciary capacity under the “prudent expert principle.”

   State law [17-6-201 (1), MCA] further defines this principle as a requirement for the board to:
   diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

   The restriction in this legislation will reduce diversification and apply investment criteria other than discharging duties solely in the best interest of the beneficiaries.
2. The restrictions on investments are so general in nature the board would not be permitted to differentiate between a company actually doing business with the countries’ governments and a company providing food, medicine, and other products or services to persons living in the country.
3. There would be up-front transition costs and long term “loss of income” but the numbers are not quantifiable at this time.

Sponsor’s Initials	*Date*	*Budget Director’s Initials*	*Date*